

**Arizona's BLCI Continues Downward Trend** The Arizona Business Leaders Confidence Index® (BLCI) declined by 2.1 points, to a reading of 40.4. This is the weakest reading yet for our survey that began in mid-2003. A number below 50 indicates deteriorating conditions. The decline was much smaller than in the prior period when the index dropped 8 points. The survey, conducted in early December, measures expectations for the first quarter of 2008.

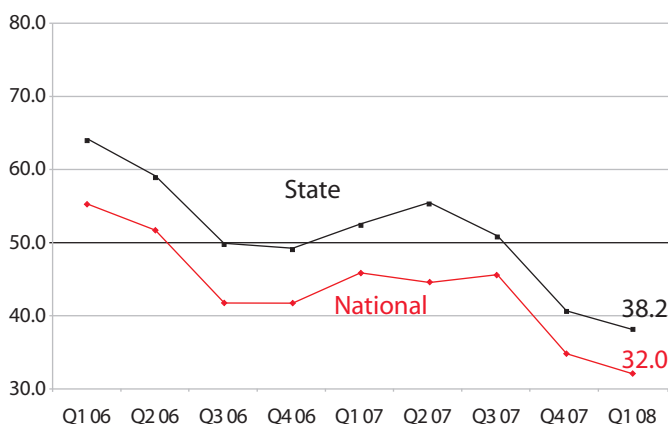
Other surveys of business and consumer confidence also reported large drops recently. Moody's Economy.com, for example, reports that their survey of business confidence stands at the lowest levels since their survey was initiated some five years ago. They note that "confidence remains especially dour and is consistent with a recession." The National Federation of Independent Business reports that their small business optimism index stands at its lowest level since 1993. Those surveys are of panelists from around the nation. Arizona BLCI panelists are exclusively from within the state.

Arizona, because of its high concentration of employment in growth-related sectors and the record-setting decline in housing markets, is struggling commensurately. At this level, the Arizona BLCI is indicative of an economy that's contracting. Our survey is forward looking, i.e., panelists were asked to record their expectations for the first quarter. With the BLCI below 50, they are expecting conditions to get worse.

**Panelists Expect Economic Conditions to Worsen** Expectations for the Arizona and national economic outlook remain bearish for the first quarter. Both components fell below 40 to the lowest readings since inception of our survey. The national component fell to only 32, indicating panelists expect U.S. economic conditions to significantly deteriorate during the first quarter.

Nearly two-thirds (66.1%) of our panelists expect the national economy to worsen in the first quarter; almost 13% expect things to be much worse. Only 7.1% expect the national economy to do better, with 26.8% expecting conditions to remain the same.

Expectations for National and State Economies



(and losing momentum) and measures of consumer spending are declining. Homebuilding continues to decline, housing prices continue to slip, inventories of unsold homes have increased to nearly 15 months supply in Phoenix, and foreclosures continue to rise. State and local governments continue to manage the challenge of balancing current budgets as sales taxes and income taxes decline.

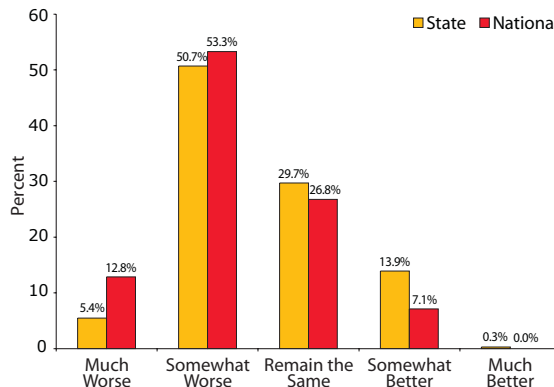
Over half (56.1%) of our panelists expect the state's economy to worsen during the first quarter. Only 14.2% expect conditions to improve. Less than a third expects the state's economy to remain the same. The state index now stands at 38.2, down 2.2 points from last quarter.

In recent months, forecasters from around the country have been revising their projections for the nation downward. Global Insight, a leading economic forecasting firm, now sees no growth in the final quarter of 2007 and less than 1% growth over the following three quarters. Two consecutive quarters of decline is the popularized definition of recession.

As 2007 draws to an end, Arizona's economy possibly could be already in a recession. More data is needed to identify exact timing, but current data indicates that the economy peaked as early as the second quarter of 2007. More likely, the data eventually may show that a recession began in the third quarter, punctuated by the collapse of the mortgage lending industry.

Housing remains in retreat, employment is barely growing

Arizona and National Economy Expectations  
1st Quarter 2008

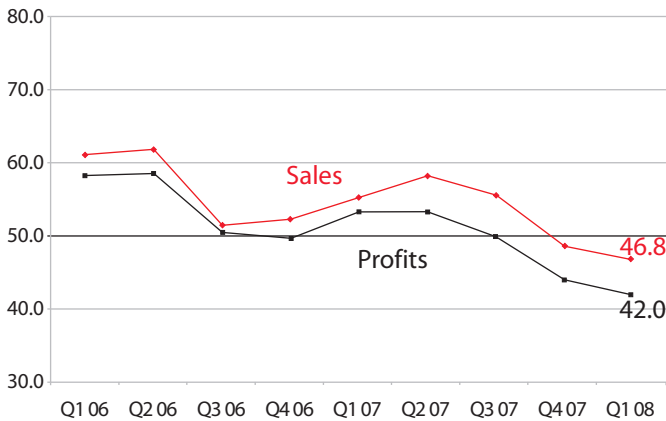


## Outlook for Industry Sales and Profits is Depressed

The buying spree by consumers appears to be over – at least for a while. For the past decade and more, consumers have spent more than they earned, resulting in falling savings rates and rising debt. Tax cuts, rising home prices and the ability to tap home equity (the major component of household wealth) have provided additional cash in recent years to support spending. Access to credit has now tightened and the home equity window is closing, so consumers are now forced to match spending with current income.

Retail sales and restaurant & bar sales (R&B) are the best measures of final sales to consumers at the state level and both continue to decline. After adjusting for inflation, both measures peaked in February and were decreasing during the summer — down near double-digit annual rates for retail and down by 3-5% for R&B.

**Sales and Profits Expectations**



Expectations for industry sales remain the strongest BLCI component, but slipped in the current survey by nearly two points. The distribution of responses is again bi-modal, meaning more panelists expect sales to either increase or decline than to remain the same. The numbers of panelists expecting sales to increase (33.2%) are overshadowed by those expecting a decrease (43.3%), while 23.4% expect no change.

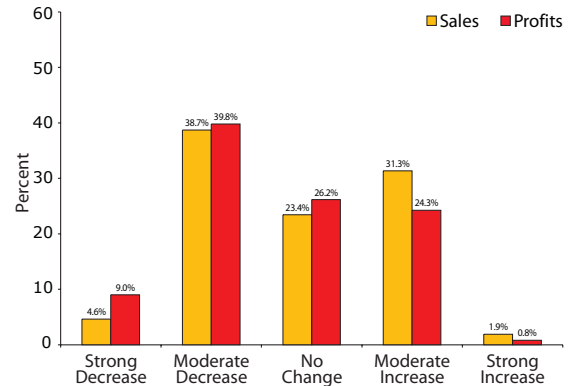
Sales and profits components of the BLCI are highly correlated as shown in the accompanying chart. Both remain below 50 – profits by a larger margin.

The profit picture has taken a turn for the worse in recent months. Over the past few years, companies have been awash

in cash and have been able to reduce debt. Profit growth is more challenging as productivity slows and pricing power is weak. Earnings of domestic non-financial companies have fallen 8.3% during the past year, which is the largest decline since the last recession. The squeeze on profits and growing pressure to control costs does not bode well for capital spending and hiring.

In our survey, expectations for industry profits slipped 2 points to an index value of only 42. Almost 49% of panelists expect profits to decline during the first quarter, while 25.1% expect an increase. Right at 26.2% see no change during the first quarter.

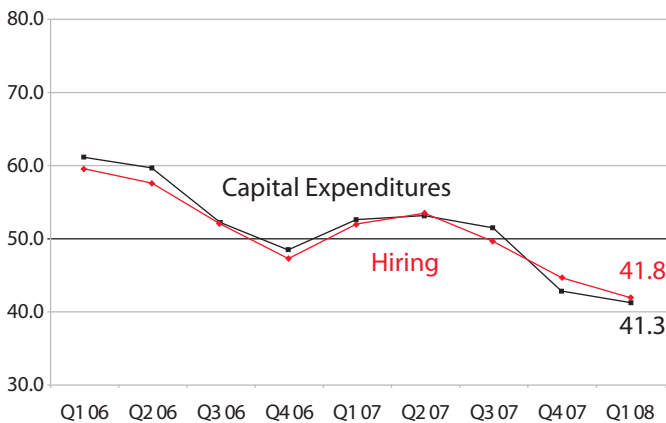
**Industry Sales and Profits Expectations 1st Quarter 2008**



## Expansion Plans Remain On Ice

Weaker profits and sales, coupled with tighter credit conditions, make it harder for companies to launch expansions. Nationwide demand for new equipment and building has softened considerably in recent months. CEOs in the Business Roundtable's recent quarterly survey dropped expectations for capital spending and hiring to the lowest level in four years.

**Expectations for Capital Expenditures and Hiring**



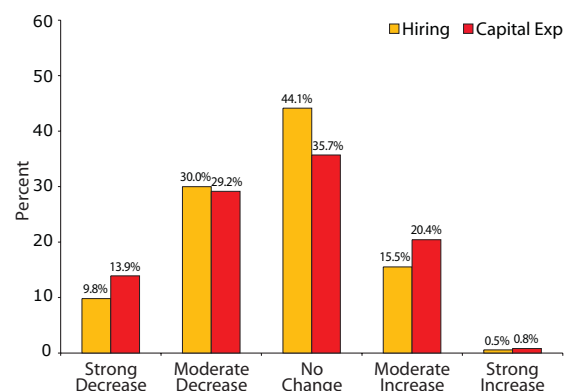
Arizona BLCI panel members also indicated caution with regard to expansion plans for the first quarter as scores for both hiring and capital expenditures dipped below 42.

The capital spending component declined 1.6 points to 41.3 with 21.2% of our panelists expecting to boost capital spending during the first quarter, compared to 43.1% preparing for a decrease. Approximately 36% expect no change in spending for capital items.

Hiring plans for the first quarter fell 2.5 points to 41.8. Right at 16% of our panelists expect their industry to add workers, while 39.8% expect decreases. 44.1% foresee no change.

Statewide, employment growth has slowed dramatically and is approaching zero. Initial unemployment insurance claims are on the rise. The last time these conditions occurred was just prior to and during the last recession. Although the unemployment rate remains at a low 3.5% in October, it will more than likely rise in coming months. Declining payrolls are being recorded in construction, manufacturing, information, financial services and employment services.

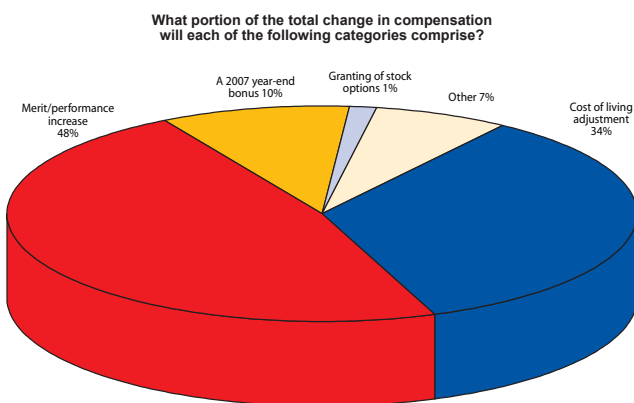
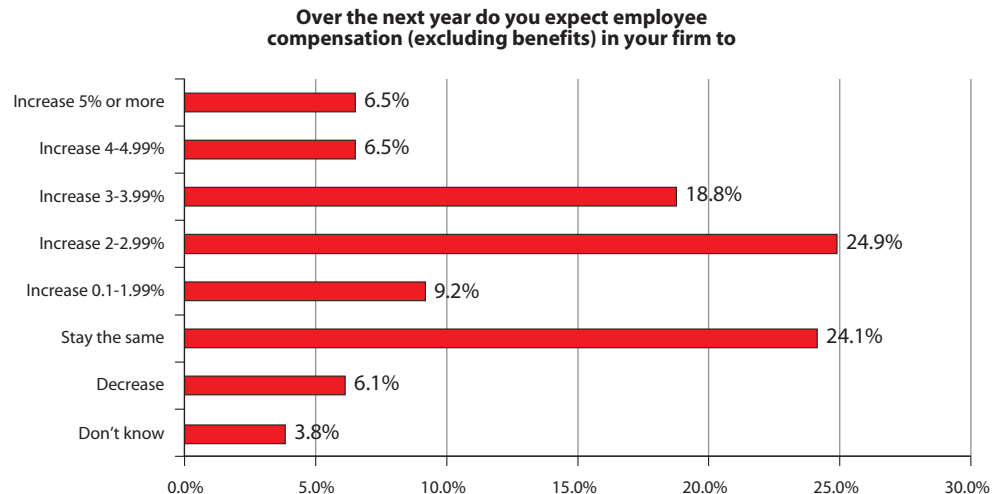
**Industry Hiring and Capital Expenditures Expectations 1st Quarter 2008**



**Topical Question Series: Employee Compensation Plans** This quarter's topical questions focus on compensation: how much will compensation rise during the next year, how are employees compensated, and the usage of year-end bonuses.

When asked about expectations for employee compensation during the coming year, the most common response (one-fourth) was an increase between 2-3%. Another 18.8% expect an increase between three and four percent. While 6.5% expect increases in the 4-5% range, another 6.5% expect increases in excess of 5%. A significant 24.1% expect compensation to remain the same, and 6.1% expect a decrease.

These results are significantly lower than recorded one year ago. Then, the largest response indicated increase in the 3-4% range, 15.5% were expecting compensation to remain the same and only 3.6% were projecting a decrease in compensation.

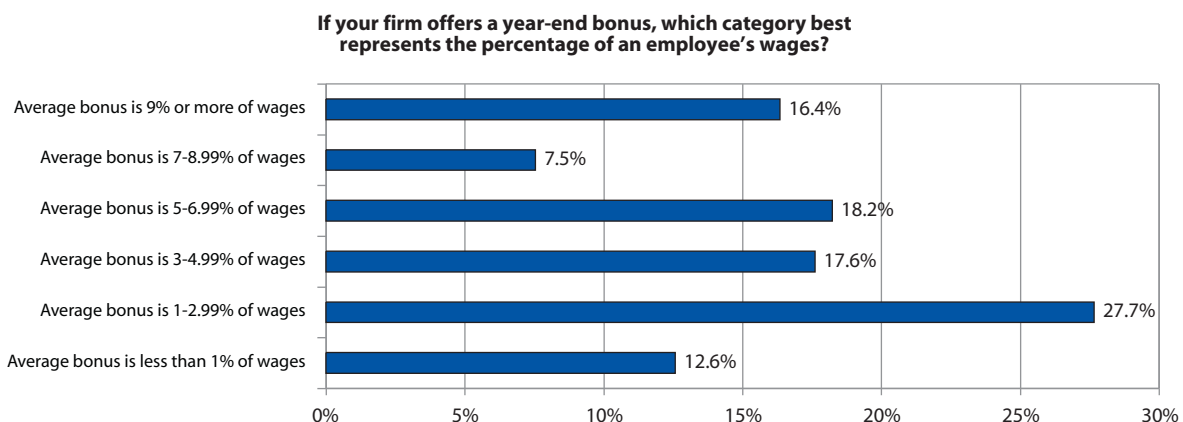


When asked how these changes in compensation would be implemented, nearly half of our panelists reported that increases would be merit or performance based. Another 34.4% indicated that compensation would reflect a cost of living adjustment. Nearly one-in-ten will offer a 2007 year end bonus. Very few (1.4%) will offer stock options.

These responses mirror national trends, as compensation plans increasingly are performance based. The results are nearly identical to those from one year ago.

For panelists whose firms do offer year-end bonuses, the amount paid varies widely. While 12.6% of those surveyed offer bonuses less than 1% of wages, 27.7% fall between 1 and 3%. Smaller proportions offer higher amounts as shown in the accompanying chart. Significantly, 16.4% offer bonuses in excess of 9%.

Compared to last year's responses, the amounts offered as bonuses this year will be a little less.



**Arizona BLCI by Component and Region** All six components fell compared to the prior survey, and all remain below 50, the dividing line between increasing and decreasing expectations. The national outlook component, which was already in negative territory, fell the most and now sits at 32. Expectations for the state economy fell to 38.2, making it the second weakest component. Sales expectations remained the strongest component, with a reading of 46.8. Hiring expectations fell 2.5 points, suggesting that panel members will be very cautious with hiring in the first quarter.

The BLCI for the Non-Metro Areas rose by nearly two points, while the two large metro areas experienced decline. The Non-Metro Areas' index is the highest at 44.4 and Metro Tucson's is lowest at 39. The Non-Metro Areas recorded the highest scores for five of the six components. Metro Phoenix panelists were the most upbeat for the national outlook. Metro Tucson panelists recorded the lowest scores for all but capital expenditures.

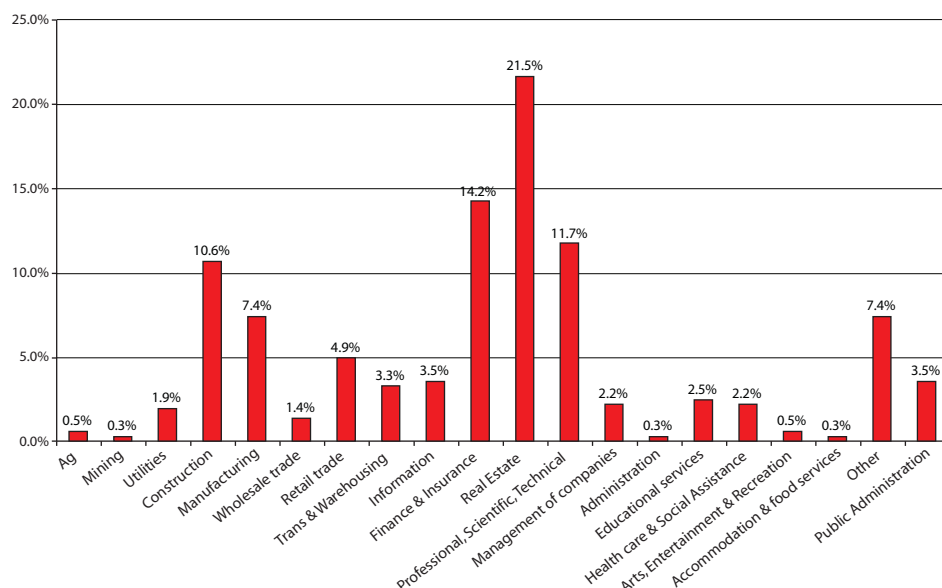
Index by Component and Region Q1 2008					
	State		Region		
	Arizona	change from Q4	Phoenix-Mesa Metro	Tucson Metro	Non-Metro Areas
Sales	46.8	-1.9	48.8	45.4	49.3
Profits	42.0	-2.0	41.8	41.6	45.3
Hiring	41.8	-2.5	41.8	40.9	46.6
Capital Expenditures	41.3	-1.6	39.7	41.4	45.3
State Outlook	38.2	-2.2	42.1	34.9	45.3
National Outlook	32.0	-2.7	35.7	29.8	34.5
<b>BLCI</b>	<b>40.4</b>	<b>-2.1</b>	<b>41.7</b>	<b>39.0</b>	<b>44.4</b>

**BLCI Calculation Notes** Panelists are asked to choose their responses from a five-point scale that includes Strong Decrease, Moderate Decrease, No Change, Moderate Increase, and Strong Increase. A numerical value ranging from -2 (Strong Decrease) to +2 (Strong Increase) is assigned to each of these. A score is then calculated for each question and transformed into a scale that ranges from 0 to 100. Index values above 50 indicate expectations for increases (or betterment), and index values below 50 indicate expectations for decreases (or worsening conditions). The BLCI combines these six measures using equal weighting.

Both total panel membership and the number completing the survey continue to expand. Many thanks to all of our panel members for making this survey a useful and reliable indicator.

We make no pretense that this survey is representative of all business leaders in Arizona. What we report here are the responses of the panelists who completed our survey. As we continue to grow the size of the panel, we will continue to add analysis for individual industries and sub-state areas. Please join us in early March for our look ahead to the second quarter of 2008. (Visit [www.blici.com/arizona](http://www.blici.com/arizona).)

**Distribution of BLCI Panelists by Industry**



**Compilation and analysis provided by Marshall J. Vest, Director of the Economic and Business Research Center at the Eller College of Management, The University of Arizona.**



The BLCI is a  
Compass on Business  
initiative created in  
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